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INSIGHT

Federal Home Loan Banks: Primary Mission Asset Ratios and Transitioning from LIBOR

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The Federal Home Loan Bank Act of 1932 (P.L. 72-304; 47 Stat. 128) created the Federal Home Loan Bank (FHLB) system, which currently consists of 11 regional institutions and the system's Office of Finance. These entities collectively constitute one government-sponsored enterprise. The FHLBs are federally chartered cooperative financial institutions, meaning that each FHLB is privately owned and capitalized by its members. Four types of financial institutions may become FHLB system members: (1) federally insured depository institutions (i.e., banks and credit unions), (2) insurance companies, (3) community development financial institutions, and (4) non-federally insured credit unions that meet certain statutory criteria. Each FHLB provides advances (cash loans) to member lending institutions in its regional district. Members may obtain FHLB advances if they have the eligible assets that can be used as collateral—typically mortgage and mortgage-related assets that promote homeownership.

The FHLBs are required by statute to administer various programs that foster affordable housing and community development. Each FHLB must set aside 10% of its annual net earnings to support the acquisition, construction, or rehabilitation of affordable rental housing in its district. The FHLBs also provide discounted advances to facilitate affordable housing as well as broader community developments in areas meeting certain eligibility requirements in their districts.

As the FHLBs' primary regulator, the Federal Housing Finance Agency (FHFA) requires calculation of each FHLB's *primary asset mission ratio (PMAR)* to monitor the extent to which its activities align with mission goals. The PMAR, sometimes referred to as *core mission asset ratio (CMA)*, is a ratio of an FHLB's asset holdings affiliated with its core mission relative to consolidated obligations. FHFA has a regulatory preferred PMAR minimum of 70% based on an average calculated over several review periods. If an FHLB's PMAR falls below 55% over several consecutive review periods, its board of directors will be required to submit to FHFA an explanation of the shortfall as well as a strategic plan to restore it at or above the 70% preferred level of mission achievement. **Table 1** shows the 2019 PMARs for the 11 FHLBs.

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Table 1. Primary Mission Asset Ratios

2019

FHLB	PMAR/CMA (percent)
Atlanta	70.9
Boston	74.7
Chicago	72.3
Cincinnati	69
Dallas	65.7
Des Moines	Not reported
Indianapolis	Not reported
New York	78
Pittsburgh	82.2
San Francisco	Not reported
Topeka	75

Source: FHLBs' Annual 10-K Reports.

Some FHLBs stated that their PMARs are being negatively affected by factors related to asset holdings linked to LIBOR, the international interest rate scheduled to be phased out after 2021. Many financial institutions calculate future payment obligations using LIBOR as a reference rate, and due to this phase-out such contractual obligations must be renegotiated and amended with alternative reference interest rates. Going forward, new financial contracts must also be linked to new alternative reference rates that will exist when LIBOR is no longer available. For this reason, the FHFA issued a supervisory letter on September 27, 2019, requiring the FHLBs to cease entering into new transactions with LIBOR-indexed financial assets, liabilities, and derivatives with maturities beyond December 31, 2021.

Consumer mortgages (e.g., adjustable rate mortgages, reverse mortgages, and home equity lines of credit) as well as multifamily mortgages—both of which may be used as collateral for FHLB advances—pose substantial financial risks if they are linked to a reference rate that will eventually no longer exist. Specifically, longer-term financial contracts without an alternative (fallback) interest rate in the absence of LIBOR would lack clarity regarding the calculation of payment obligations and, therefore, generate cash flow uncertainty and possible instability. The discontinuation of LIBOR also poses risks that could result in improper consumer disclosures, possibly violating the FHLBs' consumer protection policies. Consequently, financial contracts linked to LIBOR that exist between the FHLBs and their members must be renegotiated during the transition period, thereby complicating the ability to calculate accurate asset values that would subsequently be used in PMAR calculations.

Author Information

Darryl E. Getter
Specialist in Financial Economics

Maura Mullins
Senior Research Librarian

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